United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

To be argued by
JACOB E. HELLER

75-7051

B P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

FIRST NATIONAL BANK OF HOLLYWOOD, DOROTHY BUCHMAN and SANDER BUCHMAN, as Executors of Samuel Buchman, Deceased,

Plaintiffs-Appellees,

—against—

AMERICAN FOAM RUBBER CORP., MILTON R. ACKMAN, as Trustee of American Foam Rubber Corp., Bankrupt,

Defendants,

MARIE LOUISE DEMONTMOLLIN, ALEXANDER F. PATHY and SUZANNE M. PATHY,

Defendants-Appellants.

BRIEF FOR PLAINTIFFS-APPELLEES

JOSEPH HELLER & JACOB E. HELLER
Attorneys for Plaintiffs-Appellees
51 Chambers Street
New York, N. Y. 10007

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Preliminary Statement

Appellee Dorothy Buchman is the sole remaining executrix of the estate of Samuel Buchman. He died November 4, 1965, three years before the respective claims were tried.

After pre-trial procedures and a trial,

(a) a judgment was entered on December 20, 1974 in favor of Appellee for $40,868.50 against appellant (hereinafter called M. L. de M.) which is the subject of this appeal (R. 259a);

(b) a judgment was entered on October 14, 1969 in favor of appellee for $65,484.40 against American Foam Rubber Corporation in bankruptcy (hereinafter called AFR) (R. 254a);

(c) a judgment was entered for $33,244.65 ($20,000 plus interest) on October 14, 1969 in favor of the trustee for the bankrupt AFR against appellee, which she paid.[1] (R. 255a)

(d) The jury returned a verdict that the appellants were not damaged by the acts of Samuel Buchman, (hereinafter referred to as B). (Judgment R. 253a)

(e) The court dismissed the first counterclaim of appellants and they discontinued with prejudice their second counterclaim. (R. 255a)

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[1] Appellee acted as her own attorney subsequent to the entry of judgment. She presumably believed in the sanctity of judgments and paid it. She took the same position as to the judgment in her favor in writing a letter to all the parties including the judges, as follows:

> "The enclosures herein will give you information about the estate of Samuel Buchman, deceased. Case No. 6B35 Bankrupcty Court and 60CW2328 Southern District of New York. I am the sole executrix of this estate, Dade County, Miami, Florida. The Internal Revenue Service is impatiently waiting for a termination of this case which should have come long ago. All the papers which I received from the archives in New York have been received by the proper authorities here in Florida and I shall seek their assistance in recovering the amount of money due this estate as per Judge Cooper's order. February 13, 1975."

It was not until July 8, 1975 that appellee came to the realization that she needed counsel's help in presenting her legal argument on this appeal. Since appellee's request for enlargement of time was granted to August 11, 1975, and the proceedings lasted over a period of over 10 years, counsel were unable to read the voluminous papers on file. Our brief is our best effort under the circumstances.

The Judgment on appeal resulted from a claim by appellee's deceased that M. L. de M. breached a subordination agreement between them.

In 195[illegible] the deceased B and M. L. de M.[2] owned the following securities:

Name of Holder	American Foam Ser. A Debentures Due May 1, 1960	American Foam Ser. B Debentures Due May 1, 1965	Burlington Debentures Due Apr. 1, 1960
Samuel Buchman	$48,000	$64,000	$12,000
de Montmollin	$63,000	$79,000	$15,000

The parties entered into what is here called a buy and sell out agreement whereby B sold his and his son's holding of securities to M L de M.

The agreement (Exhibit A) contained a subordination provision, the paragraphs of which gave rise to appellee's cause of action. They read:

A. Part I

> "To induce Samuel Buchman to sell his capital stock hereunder Marie Louise de Montmollin and Alexander F. Pathy hereby agree with respect to the debentures of each of said corporations that the rights of any holder (including her or him) of the debentures thereof so held by her or him and referred to above, shall in all respects be subordinated to the rights of any holder or holders of the debentures thereof now

[2] The judgment entered in favor of appellee is only against M L de M and therefore no reference is made to defendant Pathy.

held by Samuel Buchman (including him) as to the payment of interest and principal. *No claim* for interest under the debentures so subordinated shall be made unless all interest payable on the debentures now held by Samuel Buchman shall have been paid in full, *and no claim* for principal under any of the debentures so subordinated shall be made *unless the entire principal* of all the debentures now *held by Samuel Buchman shall have been paid in full.*"[3]

A. Part II

"If for any reason either corporation shall pay interest or principal on said debentures to any of the buyers, or to any person deriving title to the debentures of said corporation from any of the buyers, and said payment shall be made without first satisfying the priority to which the holder or holders of Samuel Buchman's debentures are entitled by reason of the foregoing provisions, the amount of the payment so made to the buyer (or to the person deriving title from him or her) shall be promptly paid by such buyer to said holder or holders of Samuel Buchman's debentures . . ."

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[3] We stress, that portion of the subordination agreement we marked A and B were intended to function separately and to cover two distinct eventualities.

Part A is an undertaking which involves B, M L de M and Pathy only. It provides that if M L de M or Pathy make a claim (demand) for interest or principal (even without payment) *all* the debentures held by B must be paid him. It does not call for payment. It speaks of making claims. They made a claim when they exchanged the debentures for preferred stock.

Part B deals with possible buyers of debentures from M L de M and Pathy. AFR or Burlington paid to the buyers either interest or principal, the buyers were required to turn over what they received to B. This is a separate and distinct obligation of the buyers only.

"B. Samuel Buchman is the holder of a Promissory Note of American Foam in the sum of $25,000. The buyers hold similar Promissory Notes aggregating $100,000. To induce Samuel Buchman to sell his capital stock hereunder, the buyers agree to subordinate the payment of (1) interest of their respective said promissory notes to the payment of interest and (2) principal thereof to the payment of principal on or of said $25,000 Promissory note held by Samuel Buchman and they further agree to make no claim for interest on their respective said Promissory notes until interest on the promissory note held by Samuel Buchman shall have been paid in full, and to make no claim for principal unless the principal of the promissory note held by Samuel Buchman shall have been paid in full."

"EIGHTH: BUYER'S WARRANTIES

A. To induce the sale of Capital stock hereunder, the buyers warrant and agree that until the entire price hereunder shall have been paid in full and until all the debentures and promissory note held by Samuel Buchman (which are described in paragraph SIXTH nereof) shall have been paid in full, neither American Foam nor Burlington will redeem or purchase any of its capital stock or make any distribution to its stockholders in the nature of a liquidation or partial liquidation . . ."

The Certificate of Incorporation of AFR was amended by M. L de M (now 100% owner of AFR) on issuance of 2,000 shares at a par value of $100.00 each (Pl. Exh. 33) by resolution, as follows:—

"That an amendment to the Certificate of Incorporation of the Corporation increasing the capital stock of the Corporation to $1,200,000 by authorizing the issuance of an additional 2,000 shares . . .

After such amendment of the Certificate of Incorporation shall have become effective, the proper officers of the corporation be and they hereby are authorized to *issue shares in payment* of outstanding indebtedness of the Corporation in the same face amount as the aggregate par value of the preferred stock to be issued therefor."

By Stipulated Facts (R. 142a, R. 200a) the Court below found that:

1. In May, 1959, de Montmollin surrendered AFR debentures and notes owned by her in the aggregate face amount of $291,000 to AFR and received in exchange therefor 2,910 shares of preferred stock. In December, 1959, de Montmollin surrendered additional AFR debentures and notes in the total face amount of $31,000 which she owned, and received in exchange 310 shares of preferred stock (PTO* 40)."

2. On April 1, 1960, the Burlington debentures held by Buchman and M. L de M became due. M. L de M's Burlington debentures in the amount of $15,000 were discharged and she received a credit for that amount on Burlington's books. She then loaned this same $15,000 to AFR . . . and received a note from AFR in that amount." (R. 201a)

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* P.T.O. means Pre Trial Order.

M. L de M had a right to draw these $15,000 from Burlington from the time a credit in her favor was placed on the books.

The Court below stated (with respect to the $15,000):

that M. L de M's debentures were discharged;

the debts of Burlington were reduced by $15,000;

the assets of AFR was increased by $15,000;

M. L de M became a noteholder of AFR for $15,000;

—hence—

L de M received payment which in turn entitled B to recover $15,000 against M. L de M together with interest from August 2, 1960 for a total of $29,016.00 (R. 204a, 205a)

The $64,000 in debentures held by B, which became due and payable May 1, 1965, were not paid.

In June, 1960 B commenced a plenary suit against AFR and the individuals party to the buy-sell agreement of May 17, 1957 to recover the $64,000 based upon the breach of .....

AFR filed a petition for an arrangement on January 17, 1961 and was adjudicated a bankrupt on February 21, 1961 (R. 136a)

Milton R. Ackman was appointed trustee. The Hon. Robert F. Stephenson was designated as Referee in Bankruptcy.

Defendants M. L de M et al. answered B's suit and counterclaimed. Thereafter Ackman, as trustee also answered and counterclaimed on behalf of AFR.

M. L de M et al. claimed to be personally damaged by a conspiracy engaged in by B with others to destroy AFR resulting in the insolvency of AFR. Ackman's (as Trustee) counterclaim was essentially for the same relief.

Before the trial on the lawsuits took place Samuel Buchman died.

The Court below dismissed M. L de M's et al. first counterclaim (in conspiracy) and M. L de M's et al. second counterclaim was discontinued with prejudice (R. 255a).

Ackman's counterclaim resulted in a verdict of $20,000 against the estate of B. The minutes (testimony) and the basis for the verdict is not in the record served by appellants.

The verdict further stated, "that the individual defendants were not damaged by the conspiracy." (R. 253a)

We find it difficult to understand how an adequate or full defense was possible in the circumstance of Buchman being dead. It is noteworthy, however, that a highly exaggerated $2,000,000 claim was cut down to $20,000. The judgment entered thereon, with interest and costs ($33,244.65) was promptly paid to the bankrupt (AFR) estate.

We find it difficult to understand the conspiracy claimed in that there was no claim in the complaint that B had connection with any competing business to which he sought to divert any AFR business.

We also find it difficult to understand the feigned innocence and good intentions of appellants who tremendously increased the indebtedness of AFR by extravagant and costly financing and borrowing which for the most likely

reason, to wit, unwise and insufficient planning, resulted in an inability by AFR to meet its debts and resulted in a collapse and bankruptcy. Of interest is the fact that Buchman subordinated his claim of indebtedness which was to expire 3/30/59. A refinancing was arranged with Heller & Co., a few days before 3/30/59, the effect of which led to bankruptcy.

Forgotten in the whole process is B whose debentures became less likely of being paid as the AFR debts rose and rose. The building of credit resulted in increased debts.

The decision below sought to compensate B for the damage caused by appellants by their acts.

The Judgment and opinions of the court below established:

a. B is entitled to recover $15,000 plus interest from August 2, 1960 (total $29,016.00) against M. L de M (R. 240a)

b. B is entitled and has a valid claim against the AFR bankrupt estate of $64,000 with interest (R. 254a)

c. B is entitled to recover from M. L de M the dividend M. L de M would have received on $291,000 if she had not surrendered her debentures and notes in that amount and had instead presented a claim in bankruptcy (R. 260a)

d. B is entitled to a Judgment for $64,000 plus interest against AFR (R. 254a)

In arriving at the opinion resulting in the judgment, the court below held:

1. The exchange or transfer by M. L de M of the $291,000 in debentures and promissory notes for which she received $291,000 in AFR stock, did not result in payment to M. L de M because AFR did not pay for the debentures out of its assets.

2. With respect to the $15,000 the Court below did find that payment was made by Burlington to M. L de M and therefore B is entitled to recover $15,000 with interest.

3. That even though "payment" was not made to M. L de M when she turned in the $291,000 in debentures and notes and accepted AFR preferred stock, the act was a breach of the May 17, 1957 agreement because this agreement was a subordination agreement and M. L de M frustrated B's rights to subordination when M. L de M lost her status as creditor (by surrendering the debentures and notes) and became a stock holder (by accepting AFR stock) in which capacity she was not a creditor but an investor.

This Court will note that in the main the decision by the lower court was based upon stipulated facts including the issues to be decided (R. 152a). We find it difficult to understand appellant's comments to the effect that issues other than contained in the pleadings were considered and decided.

We submit that only damages and the amount thereof as found by the trial court is before this court. The manner of arriving at the damage is not material if the end result is correct and it becomes appellant's burden to establish there was no reasonable basis. *West Weir & Bartel, Inc.* v. *Mary Carter,* 25 A.D. 2d 81, 267 N.Y.S. 2d 29 at page 34.

Statement of the Issues

1. Appellees submit that the opinion and that part of the judgment awarding to them the $15,000 plus interest (total $29,016.00) was clearly warranted under the facts and the law.

2. Appellees submit that there was in fact and in law "Payment: within and under the intendment and under the May 17, 1957 buy-sell agreement; that judgment should have been rendered not only against AFR for $64,000 plus interest but also against M. L de M and the other defendants.

A consideration of the separate obligations arising under Par. SIXTH Part I and Part II establish that proof of payment is not a sine qua non for liability. We refer to "payment" as defined by appellants. Our definition of payment does not require a transaction in which AFR's cash assets are depleted.

We also maintain that the breach of the buy-sell agreement in and of itself gives rise to a liability of $64,000.00.

3. That in any event the decision below that B is entitled to recover from M. L de M the amount of the dividend M. L de M would have received if she had not breached the subordination agreement of May 17, 1957 and had filed a claim for the $291,000 is eminently proper under the facts and the law.

4. That M. L de M does not have a right under the facts and the law to maintain that the verdict in favor of Ackman, as Trustee in Bankruptcy, constitutes a "collateral estoppel" against B to recover the award the Court below made to B against M. L de M.

POINT I

The award to appellee of $15,000 plus interest was clearly warranted under the facts and law.

The Subordination agreement (Exh. A) clearly and unmistakenly provides that if M. L de M receives payment from AFR or Burlington on her debentures, that the amount of the payment so made to her shall be promptly paid by her to B.

The facts are irrefutable that on April 1, 1960 Le de M surrendered the $15,000 in debentures she held; she received a credit for the $15,000 on the books of Burlington and had the right to draw these $15,000 from Burlington. M. L de M thereafter loaned the $15,000 to AFR and received a note of $15,000 from AFR.

The Court below viewed the above facts as constituting (a) payment and a discharge of Le de M's debentures; (b) that the liabilities of Burlington were reduced by $15,000 and those of AFR were increased by $15,000. The Court concluded that this constituted payment to M. L de M and since the $64,000 owed to B on his debentures was not paid, B is entitled to recover $15,000 from M. L de M.

Defendants/Appellants urge that in accepting a note for the debentures was a mere bookkeeping entry and resulted in no cash.

It is quite obvious that defendants schemed to avoid payment of the $15,000 derived from the surrender of the $15,000 Burlington debenture.

What was the legal effect of the $15,000 transaction?

Taking a note in payment and not merely as evidence of a debt extinguishes the debt. *Schalom* v. *Zuckerbrat*, App. Div., 2d Dept.—29 App. Div. (2) 571, 286 N.Y.S. (2) 364. The test is this: Can an action lie on the original obligation of the $15,000 debenture? If it can, the note is considered as collateral. If no action could lie on the debenture, the note is deemed payment. The $15,000 debenture was surrendered, cancelled, marked paid on the books and a note payable established. Therefore, no action could ever lie on the debenture and the note must be considered payment.

Appellant's brief does not seriously argue the contrary.

Appellant argued that the $15,000 item was not part of the pleadings or proof and hence the award was improper not as a matter of law but as a matter of equity.

We were not privy to the proceedings.

We do know that the claim was to recover $64,000 for breach of the May 17, 1957 agreement (R. 147a).

We note that the May 17, 1957 agreement, Par. VI recites that M. L de M holds $15,000 in debentures of Burlington due April 1, 1960 and the restriction assumed by M. L de M applies to this item.

We note that by the Pretrial order 38 (PTO38) that M. L de M's Burlington debentures in sum of $15,000 were paid.

The Court below stated and found (R. 202a):

> "That the complaint, as amended by the Pre-trial order, asserts that each of the three transactions enumerated to wit, the sale of Pathy's series B AFR debentures

to de Montmollin, the exchange of de Montmollin's AFR debentures for preferred stock, and the discharge of de Montmollin's Burlington debentures and loan by her to AFR, constituted a breach of the subordination provisions."

In fact, Pathy testified to the $15,000 matter (R. 183a).

We submit that appellant's position is not well taken.

Appellant is misleading when he estimates that B's claim was for $28,800.00 and not $64,000. The claim against appellants at all times was for $64,000 (R. 17a).

POINT II

The transactions in which appellant surrendered $322,000.00 of debentures and notes to AFR for which she received preferred stock in the same amount (3220 shares of $100 par value each) was for the purposes of the buy-sell and subordination sections . . . "payment."

In our caption to Point II we placed the word "payment" in quote.

The reason we have done so is that "payment" has no statutory or similar definition. "Payment" is a conclusion to be drawn. The objective or true criteria is—"do the facts in the given situation permit of a finding that the debt or obligation was discharged? If discharged, the court will decide that 'payment' was made."

Put in another way, payment results from a discharge.

The manner in which a discharge is effected, be it by cash, check or any other form is not material, in our view. This

is more so true in view of the absence of any claim by the obligee that the obliger did not perform the obligation of its agreement.

A reading of the cases, finding as a matter of fact or law that "payment" was or was not made will reveal only that the decisions found that the debt was or was not *discharged.*

The concept we advance was enunciated in:

Morley v. *Calhoun,* 7 Circ. Ct. R.N.S. 285 (Ohio)

wherein it was stated, it (payment) includes the ideas of satisfaction and discharge in any manner and in any form.

To the same effect are:

Carpenter v. *Dummit,* 297 S.W. 695, 700;
Hopson v. *Aetna Axle,* 50 Conn. 597, 601;
In Re Gray's Estate, 290 N.Y.S. 603, 607, 160 Misc. 710;
In Re Montague v. *Bank of N. Y.,* 88 N.Y.S. 21, 31, 94 A.D. 219;
Beals v. *Home Ins. Co.,* 36 N.Y. 522;
First Citizens Bank & Trust of Utica v. *Speaker,* 287 N.Y.S. 831, 832, 159 Misc. 427.

"Payment" need not necessarily be effectuated in money, unless the obligation so requires and unless the obliger does not waive it.

Chase National Bank v. *Schleussner,* 167 Atl. 808, 117 Conn. 370.

In *Arkansas Fertilizer* v. *U. S.,* 193 F. 667, 673, the Court in considering the word "pay" under the Interstate Commerce Act, said,

"It should not be interpreted in the narrow sense of a money transaction—it is equally a payment . . . to be relieved from an obligation, which the law imposes;"

In *Moses* v. *U. S.*, 28 F. Supp. 817, the Court stated:

"Delivery to creditor of money *or some other valuable thing* and creditor's receipt thereof for the purpose of extinguishing debt, is payment."

To the same effect is:

Chrysler Corp. v. *Hanover Ins. Co.*, 350 F.2d 652, 656;
Thomas v. *Board of Review*, 199 Atl. 2d 33, 36;
U. S. v. *Isthmian S.S. Co.*, 79 S. Ct. 857, 359 U.S. 314.

The giving of a credit to itself on the AFR books for the debentures received, is one indicium of payment.

H. Feldman's Sons v. *Netsky*, 35 Atl. 2d 305, 306, 307.

Since the acceptance of AFR stock was not received as only evidence of the debt on the debentures and notes and the said debt having been extinguished, the AFR stock must be deemed payment.

Industrial Bank of Commerce v. *Shapiro*, 276 App. Div. 370, 372; affd. 302 N.Y. 586, 96 N.E.2d 619.

The disposal by appellants of their debentures and promissory notes, which destroyed their position as creditors of AFR may be compared to an anticipatory breach resulting in an immediate liability to B for the full $64,000

and not merely to be measured by the dividend appellants might receive in bankruptcy if they had not anticipatorily breached the agreement.

D'Agostinos Executors v. *Hayward Robinson Co.*, 480 Fedl. Rep. 2d 1077 (2d Cir. 1970).

We cannot accept appellant's admission that equating "payment" with "legal discharge" is technical and hence should not be applied in our case. The spirit of the buy-sell agreement requires an equitable and legally tenable interpretation. The very acts of increasing AFR's debt jeopardizing AFR's ability to pay B's debentures is sufficient warrant for equating discharge with payment.

We also must suggest that we need not accept the trial court's view of payment as requiring that a discharge of the debentures out of surplus funds of AFR. The view advanced by Judge Cooper correctly states the stricture upon a corporation. It does not state the situation of an act of M. L de M, as an individual, with herself as the controlling actor for AFR.

The following bookkeeping entries speak volubly of the *discharge* of the debenture obligations to M. L de M, and are further indicia of "payment."

We also ask this Court to note that the consolidated financial statement of AFR for February 2, 1958 under Long-term Debts lists $373,000.00 in 5% debenture bonds and notes payable of $100,000 and $25,000 (Defendants Exh. EP).

On the statement of March 30, 1958 (Defts. Exh. EQ) the Long term debts shown are in the sum of $142,000 for 5% debentures and notes payable of $31,000 and $35,000.

On the July 17, 1960 statement and letter dated August 18, 1960 the only long term debt listed is B's $64,000 in debentures and no notes payable (Exh. 35).

We submit these exhibits are evidence of "Payment" by discharge of the obligation.

POINT III

Proof of payment as defined by the court below or as claimed by appellants was not required to sustain a recovery.

We ask this Court to consider Part I and Part II of the May 17, 1957 agreement separately. We also ask this Court to consider the import of the obligations of appellants under the buy-sell agreement not containing the word PAYMENT.

We accept *Laba* v. *Carey*, 29 N.Y. 2 302, as correctly holding that unambiguous terms of the contract must be accepted and the words and phrases employed must be given their plain meaning.

We maintain that the unambiguous terms when given their plain meaning sustain our herewith proposed position.

Part I deals only and exclusively with the obligations of appellants (including M. L de M) to B. Part I states (paraphrased) that M. L de M may not make a *claim* (we stress the use of the word claim) for interest or principal on their debentures and notes . . . and if M. L de M does . . . (i.e., makes a claim) the entire principal on B's debentures shall be paid in full.

Viewed, therefore, from the point of view of making a claim, there can be no question that two separate claims were made by M. L de M to discharge her debentures and notes.

On the $15,000 debentures of Burlington held by M. L de M, she not only made a claim but in fact received payment. The award to B on the $15,000 is supportable on either or both grounds. We urge that on the same basis the award should have been for the $64,000.

It is our view that Part II of the Buy-sell agreement refers to sale by appellants (including L de M) to *other buyers* (not AFR or Burlington) and it provides that the payments received from the buyers must be turned over to B to discharge his debentures etc. It is only if AFR or Burlington is deemed to be a buyer, under Part II, do we have the question whether the transaction in which M. L de M turned in $293,000 in debentures and notes receiving $293,000 in AFR capital stock constitutes payment.

We submit that this has been established but need not be if Part I is deemed applicable in accordance with our asserted interpretation.

We also submit a different theory for establishing the right to a recovery of $64,000.00 or any part thereof found to be due appellees. This is, that the consequence of a unilateral, anticipatory breach of the buy-sell agreement is sufficient in and of itself to sustain the recovery.

POINT IV

Minimally the award to B of $11,514 plus interest representing the amount of the dividend M L de M would have received in bankruptcy had she not surrendered her debentures and notes and lost her status as a creditor, to which amount we would be entitled under the subordination agreement, was fully warranted under the facts and law.

The subordination provisions in the Buy-sell agreement are set forth in the STATEMENT.

The trial Judge made a learned, extensive and careful review of the text book and decisional law on the subject.

Where a debt is subordinated in the event of the debtor's bankruptcy, the senior creditors (Buchman) will receive double dividends out of the bankrupt estate. The dividend paid on the senior debt and, by reason of the subordination agreement provisions requiring them to be turned over to the "senior creditor," the dividend paid on the subordinated debt.

> Caligar—SUBORDINATION AGREEMENTS, 70 Yale Law Journal 376, 377.

Typically in the case of a small corporation, the subordination of loans by the corporation's principals, to the obligation of the "senior creditor," is the form employed.

> Caligar (*supra*), p. 378.

Protection against the conversion of the subordinated debt into capital stock is a typical subject matter of a subordination agreement. The subordinated debt once con-

verted into capital stock changes the status of the subordinated debtor to that of a stockholder. As a stockholder, the previously subordinated debtor would not share in the debtor's assets with the (senior creditor) senior debt in the event of a distribution to creditors.

Sections 64b and 65a of the Bankruptcy Act, recognize and sanction priorities either given by law or by lawful contractual arrangements between the parties.

> *In Re Aktiebolaget Krenger & Toll,* 96 F.2d 768, 770 (2d Cir., 1938).

There are inchoate and complete subordination agreements.

In *Pioneer Cafeteria Feeds Ltd.* v. *Mack,* 340 F.2d 719 (10th Cir 1965) one Wyse was the principal stock holder of Northland; he agreed to postpone payment due or to become due him from Northland until after payment in full to Pioneer Cafeteria. This agreement was termed a "complete subordination." Coogan, Kruple & Weiss, 79 Harv. Law Review 229 at 234.

Under both types, inchoate and complete subordination agreements, the practical effect is to make the subordinated debt a type of security for the senior debt, available to the senior creditor upon a distribution of the assets of the debtor.

> Caligar (*supra*) p. 378.

But in the case of the complete subordination, the subordinated debt is "locked in" and its distributional value in bankruptcy becomes, in effect, just as much a security benefiting the senior debt holder as would, for example,

a chattel mortgage in the hands of the foreclosing mortgagee.

The Bankruptcy Court (hence the U.S. District Court) has the jurisdictional power to enforce the contractual rights of the parties in interest when distributing a bankrupt's estate.

> *Bank of America Natl. Trust & Sarassin* v. *Erickson,* 117 F.2d 796, 798 (9th Cir., 1941).

In our case a plenary suit was instituted on the contract. The District Court decided the issues but did so with an awareness and in conformity to the Bankruptcy Proceeding before the Referee.

In *Cherno* v. *Dutch American Mercantile (Itemiab Inc. Bankrupt),* 353 F.2d 147 (2d Cir., 1965) the Court cited with approval *Dodge-Freedman Poultry* v. *Delaware Mills,* 148 F. Supp. 617, aff'd 244 F.2d 314, and stated:

> "Judge Connor properly found that it was 'well settled practice in bankruptcy for courts to enforce agreements between creditors which provide for subordination in liquidation,' that a constructive trust for the benefit of Delaware Mills Inc. existed as to the dividend to be distributed to Harry Freedman and that the attempt by Harry Freedman to use the dividend to his own ends and purposes would violate the constructive trust. This issue was actually one only between Delaware Mills Inc. and Harry Freedman."

In the *Matter of Credit Industrial Corp., Bankr.,* 366 F. 2d Rep. 402 (2d Cir., 1966) at page 412, the Court stated:

> "the district court dismissed as frivolous Levin's claim that the subordination provisions contained in his debt

instrument were unenforcible because they were too vague, and in addition, because the agreement failed to provide expressly that they applied to bankruptcy proceedings. We affirm that determination. The subordination provisions are clearly and precisely worded, and represent an unambiguous agreement. . . .

Moreover, the subordination provisions are all encompassing and preclude payment to the holder whenever there is an unsatisfied outstanding senior debt. Any reference to bankruptcy proceedings would have been superfluous in view of the broad terms of the subordination provisions. Cf. In re Aktiebolaget Krenger & Toll, supra, 86 F.2d 770.

Whether considered in terms of equity, estoppel or constructive trust, the court will go beyond mere appearance and external form to expose the true purposes, objects and consequences of a transaction.

People's Ticonic Bank v. *Stewart,* 86 F.2d 359, 361.

The Court will and should prevent the parties, who gave the subordination, to unilaterally destroy it and thus deny to the senior creditor his contractual rights.

In re Dodge Friedman Poultry, 148 F. Supp. 647.

One must conclude the trial court correctly found on the issues of law and fact that a breach of contract had occurred.

On the issue of damages, appellee is entitled to a recovery on the same basis.

"Once the fact of damage is established, the aggrieved party may sustain his burden of proof on the amount of damage by proof on any reasonable basis."

"There are no rigid rules for the fixation of damages. The difficult area, more than most, requires pragmatic adjustment of factors with the object of producing a result which makes the aggrieved plaintiff whole to the same degree as full performance would have availed him. The qualified approximation of damages . . . would appear to meet the test if practically viewed and practically applied."

West Weir Bartel Inc. v. *Mary Carter,* 25 App. Div. (2) 81, 267 N.Y.S. (2) 29—1966.

POINT V

The defense to a recovery by appellee based on alleged collateral estoppel arising out of the recovery by the Trustee in Bankruptcy of $20,000 against the Estate of Samuel Buchman as constituting a release in favor of M L de M is not valid under the facts and the law.

The theory advanced by Appellee for which *Royal Business Funds* v. *Corp.,* 356 N.Y.S.2d 407 is cited, is that:

Samuel Buchman impaired the "collateral" i.e., impaired AFR corporation assets, hence M. L de M was released of her "guarantee" to Buchman.

The asserted "facts" and legal principles are not applicable to our case.

Royal Business, supra is a case in which the person asserting collateral estoppel guaranteed the payment by the corporation of the note upon which suit was brought.

In our case M. L de M was not a guarantor that AFR would pay the $64,000 in debentures held by B.

In our case the verdict in favor of the Trustee in Bankruptcy against the Estate of B established the extent of the diminishment of the AFR assets by B's alleged acts. Assuming that the Estate of B could (after B's death) and did have the opportunity to present a proper defense in the suit (*Schwartz* v. *Public Admr.*, 24 N.Y.2d 65), the fact is that the verdict (with interest) was paid. Thus, the assets of AFR, if diminished previously, were fully replenished.

We further submit that the asserted defense is not applicable for two other reasons:

FIRST: The Court below held that appellants had no rights to assert, based upon the claim of a conspiracy by B to deplete AFR's assets.

The verdict of the jury after trial was:

"The individual defendants were not damaged by the conspiracy" (R. 153a).

SECOND: The Judgment awarded $64,000 in favor of B (R. 254a).

CONCLUSION

The procedure followed by the Court and the litigants was alwa s on a consent basis. Due consideration was given by Judge Cooper to the manifold motions and contentions. His factual determinations are sound and should not be disturbed. The only error appellee finds is that the amount plaintiffs were entitled to was $64,000, the full amount claimed. Considering the fact the Estate paid $33,244.65 and substantial legal fees, the judgment in favor of B's Estate for $40,868.58 is fair and equitable.

Respectfully submitted,

JACOB E. HELLER
JOSEPH HELLER
Attorneys for Appellees
Office & P.O. Address
51 Chambers Street
New York, N.Y. 10007

SERVICE OF THREE (3) COPIES OF THE WITHIN

Brief IS HEREBY ADMITTED

THIS 8th DAY OF Aug 1974

Weed, Neuburger & Sive

Attorney(s) for Appellants

LEE PRINTING COMPANY, INC., 95 MORTON ST., N.Y. 10014—691-6300